(36)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 220

TRINITY CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

ROBERT ASH,
Munsey Building,
Washington, D. C.
Attorney for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

Brief in Support of Petition for Writ of Certiorari

TABLE OF CASES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. ......

TRINITY CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The above-named petitioner, by its counsel, prays that a writ of certiorari issue to review the judgment entered against the petitioner by the United States Circuit Court of Appeals for the Fifth Circuit in the above-entitled cause on April 21, 1942. (R. 102)

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The petitioner, hereinafter sometimes called the taxpayer, is a Texas corporation with capital of $50,000.00 divided into 5,000 shares of no par value. Its principal asset, prior to December 1, 1937, was the Trinity Building in Ft. Worth, Texas. (R. 16)

In 1935, the Commercial Standard Insurance Company of Ft. Worth, Texas, acquired all of the capital stock of the taxpayer for $625,000.00, or $125 per share. (R. 16, 24)

During the course of an examination by the Insurance Departments of the State of Texas, Illinois, Oklahoma and Tennessee, as of December 31, 1936, the examiners suggested to the Commercial Standard Insurance Company that, in order to comply with Texas statutes, the Trinity Building, its home office building, be included in its assets as real estate instead of stock, inasmuch as the stock actually represented real estate. (R. 16, 24, 41, 48)

As a result of the above-mentioned suggestion, the following transactions occurred simultaneously on December 1, 1937:

(1) The taxpayer transferred the Trinity Building, and the lease on the ground on which it stands, to the Commercial Standard Insurance Company. The building had a depreciated cost of $617,350.54 and was encumbered by a first mortgage of $259,500.00, which was assumed by the Commercial Standard Insurance Company. (R. 17, 24) The ground lease was for a definite ten year period from December 1, 1937, with four successive options of renewal, each for a ten year period, or until 1987. (R. 46, 70)

(2) The Commercial Standard Insurance Company transferred the Reynolds-Penland Building, Dallas, Texas, to the taxpayer. The building had a basis for depreciation of $40,000.00, a depreciated cost of $263,636.16, and was encumbered by a mortgage of $150,000.00, which the taxpayer assumed. (R. 17, 24)

(3) Commercial Standard Insurance Company paid the taxpayer $60,000.00 in cash. (R. 17, 24)

(4) Commercial Standard Insurance Company transferred to the taxpayer 2,920 shares of taxpayer's own capital stock. (R. 17, 24)

At the time the exchange was made, the parties had an oral understanding regarding taxpayer's stock, which was reduced to writing in 1939 at the request of the insurance examiners. It provided that the taxpayer would set over and deliver to the Commercial Standard Insurance Company all of its 3,000[1] shares of treasury stock, as, if, and when the lease assignment of the ground lease on which the Trinity Building stands "shall fail of renewal and shall not be renewed, held and enjoyed by Commercial Standard Insurance Company during the period prior to November 30, 1987".

> "To guarantee and make certain its said obligation in regard to said stock as herein set out, Trinity Building Corporation attached hereto, and delivered herewith, certificates representing said 3000 shares of treasury stock, it being definitely understood and agreed that ownership thereof shall be, and is hereby, retained by the Trinity Life Building Corporation[2] which shall have and enjoy all the dividends, benefits, voting privileges and revenues thereof until such time as ownership may be transferred to the Commercial Standard Insurance Company under the provisions hereof.
>
> "Trinity Life Building Corporation hereby agrees that it will not cause or permit the increase, decrease or alteration of its capital stock structure, during the life of this obligation, without the consent of the Commercial Standard Insurance Company first had and obtained." (R. 24, 41, 90, 91)

---

[1] 2,920 shares were transferred to the taxpayer in the transaction here involved.

[2] A former name of taxpayer.

Actually, the stock above referred to was kept in the Commercial Standard Insurance Company's lockbox at all times. (R. 42)

Taxpayer made a profit of $13,032.88 in 1930 and losses each year thereafter through 1936, aggregating $112,070.98. (R. 25) The principal of the mortgage had to be reduced $28,000.00 per year. (R. 43)

In 1938 the taxpayer sold 320 shares of its treasury stock to the Commercial Standard Insurance Company, for its book value of $73.34539 per share. The transaction was to provide the taxpayer with money to improve the Reynolds-Penland Building for a desirable long term tenant. (R. 25, 45, 49) At all times, before and after the sale, the Commercial Standard Insurance Company was the sole stockholder of the taxpayer. (R. 45, 46)

In its return for 1937 the taxpayer reported that the transactions here involved resulted in neither gain nor loss to it. (R. 25)

The Commissioner of Internal Revenue, in the notice of deficiency, divided the book value of the taxpayer's assets immediately prior to the transfer of the Trinity Building, by its 5,000 shares of authorized stock, and thus determined the value of the stock the taxpayer received in the transaction. He then valued the Reynolds-Penland Building at an appraised figure, rather than book value. The result was a determination of capital gain of $89,996.11 and deficiencies in income and excess profits taxes of $29,876.93 and $11,259.40, respectively, most, but not all, of which are due to the adjustment mentioned. (R. 10-14, 25, 26)

Two expert witnesses testified that, even without considering the restriction on the sale of taxpayer's stock, it had no fair market value, or a very nominal value. (R. 54, 55, 63) The restriction on the sale of the stock meant that no one would purchase it. (R. 56, 63)

The Board of Tax Appeals held, despite the fact that the petitioner at all times had but one stockholder, (1) that it realized gain when it received the 2,920 shares of its own

stock and (2), the restriction on the sale of the stock did not deprive it of market value and bring it within the rule of *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481. The reason for this conclusion was that the stock could have been sold subject to the fifty-year restriction. The Circuit Court of Appeals affirmed.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The decision below is in conflict with the established lay that "income" to be taxable must have "exchangeable value", as expressed in cases such as *United States* v. *Phellis,* 257 U. S. 156.

In the case at bar, the tax is based upon the receipt of the taxpayer's own stock from its sole stockholder. It gave up value for the stock so its assets actually were diminished. Its only hope of getting that value back into its treasury is by selling the stock, which, in turn, will create a corresponding new liability to the purchaser. Actually, therefore, the stock it received did not constitute income, because it had no "exchangeable value".

The rule is expressed by the Second Circuit in *Borg* v. *International Silver Co.,* 11 F. (2d) 147, 150:

> "They (treasury stock) are not a present asset, because, as they stand, the defendant (the corporation) cannot collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate Treasury by creating new obligations."

II.

The decision below is in conflict with the established rule that "the income tax laws are concerned only with realized gains". *Helvering* v. *Bruun,* (C. C. A. 8), 105 F. (2d) 442. "The purpose of the revenue act is to tax only gain". *Weiss* v. *Weiner,* 279 U. S. 333, 335.

In the case at bar there was no realized gain. Actually, the assets of the taxpayer were decreased. If any gain were

to be realized, it could only be by the resale of the treasury stock. As heretofore stated, such resale would result in new liabilities to the new stockholders.

III.

The transaction is not taxable under the regulations. Prior to 1934, Treasury Regulation provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock". A 1934 amendment to the regulations provided for computing gain or loss "if a corporation deals in its own shares as it might in the shares of another corporation", and depending "upon the real nature of the transaction". The "real nature of the transaction" is, as previously pointed out, that nothing of "exchangeable value" was received by the taxpayer.

This Court long ago decided that a single instance of the acceptance of stock in payment of a debt with a view to its subsequent sale does not "amount to a dealing in stocks". *First National Bank* v. *National Exchange Bank,* 92 U. S. 122, 128.

An isolated transaction between a corporation and its sole stockholder certainly is not dealing "in its own shares as it might in the shares of another corporation".

> "It is at least arguable that this means to cover only speculations of a corporation, * * *" *E. R. Squibb & Sons* v. *Helvering,* (C. C. A. 2), 98 F. (2d) 69, 70.

Consequently, the transaction was merely a capital transaction which did not result in "income" under the Constitution or the amended regulations.

IV.

The decision below is in conflict with established law regarding unambiguous statutes, that:

> "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are

deemed to have received congressional approval and have the effect of law." *Helvering* v. *Winmill,* 305 U. S. 79, 83.

From 1918 until 1934 Treasury regulations provided that a corporation realizes no gain or loss from the purchase or sale of its own stock. In 1934 the regulation was amended to provide for the computation of gain or loss in certain circumstances where a corporation purchases or sells its own stock.

In *Helvering* v. *Reynolds Tobacco Co.,* 306 U. S. 110, and *First Chrold Corporation* v. *Commissioner,* 306 U. S. 117, this Court held the amended regulations could not be retroactively applied to 1929 and 1933 transactions. The Court in the *Reynolds* case specifically refused to decide if the amendment to the regulation were valid when applied prospectively. The case at bar clearly presents this vexing and unsettled question.

In the *Reynolds Tobacco* and *First Chrold* cases, the corporation's stock was purchased and resold. In the case at bar, we are concerned with an isolated acquisition of a portion of the sole stockholder's stock in exchange for a part of the corporation's assets.

V.

The decision below is in conflict with *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481.

In the *Tex-Penn* case certain stock was received in a reorganization, with the recipients orally agreeing that they would not sell the said stock while a banking syndicate was selling the remaining stock. The oral restriction was for 90 days and was later extended for an additional 90 days. This Court held (p. 499):

> "the shares of Transcontinental stock, regard being had to their highly speculative quality and to the terms of a restrictive agreement making the sale thereof impossible, did not have a fair market value, capable of being

> ascertained with reasonable certainty, when they were acquired by the taxpayers."

In the case at bar the stock was speculative as the company had consistently lost money after the first year of its existence. (R. 25) In addition, the stock could not have been sold to third parties for 50 years, because (1) the taxpayer was bound to deliver it to guarantee the renewal of the ground lease, (2) until 1987 the taxpayer could not increase, decrease, or change its capital structure and, (3) the restriction was required by the state insurance examiners, so had to be obeyed.

The Court below distinguished the *Tex-Penn* case by stating (R. 102):

> "However, the sale of the stock was not forbidden by the agreement; the sole effect of the restriction imposed was that a purchaser would take subject to the terms of the agreement."

We submit that it is pure nonsense to say that a stock in a losing venture and subject to the said restrictions for 50 years had a fair market value. The decision is in direct conflict with the *Tex-Penn* case.

VI.

The decision below is in conflict with the decision of the Second Circuit in *Propper* v. *Commissioner*, 89 F. (2d) 617.

In the *Propper* case, stock was received subject to a five-year restriction against sale or transfer without the written consent of the bankers. The Second Circuit reversed the Board on the authority of the *Tex-Penn* case. It is obvious that in the *Propper* case an agreement to sell subject to the restriction could have been made.

VII.

The decision below is in conflict with the decision of the Seventh Circuit in *Schuh Trading Co.* v. *Commissioner*, 95 F. (2d) 404.

In the *Schuh* case stock was received with the understanding that it could not be disposed of for six months, without the written consent of one of the parties to the transaction. On the authority of the *Tex-Penn* decision, the Board of Tax Appeals was reversed. In the *Schuh* case, as in the case at bar, the stock could have been sold subject to the restriction.

CONCLUSION.

For the reasons stated, the petition should be granted.

Robert Ash,
Munsey Building,
Washington, D. C.
Attorney for Petitioner.